

(Revised)

Part III – Administrative, Procedural, and Miscellaneous

Auction Rate Preferred Stock—Effect of Liquidity Facilities on Equity Character

Notice 2008-55

SECTION 1. Purpose

This Notice provides guidance regarding the effect of adding certain liquidity facilities to support certain auction rate preferred stock on the equity character of the stock for Federal income tax purposes under the Internal Revenue Code of 1986, as amended (the “Code”). (Except as noted, section references in this Notice are to the Code.) Previously, in Rev. Rul. 90-27, 1990-1 C.B. 50, the Internal Revenue Service (“IRS”) ruled that certain auction rate preferred stock qualified as equity for Federal income tax purposes, but that ruling did not address the question of the effect of guarantees or liquidity facilities on such equity character. This Notice is intended to provide greater certainty and flexibility regarding certain Federal tax issues that have arisen in connection with efforts to address liquidity needs in the auction rate securities market as a result of recent significant auction failures in this market.

SECTION 2. Background

2.1 Certain Auction Rate Preferred Stock

This Notice addresses auction rate preferred stock issued by eligible issuers described herein with terms that are described generally herein (“auction rate preferred stock”). In general, auction rate preferred stock is preferred stock in which the dividend rate is reset periodically (typically every seven to 28 days), pursuant to an auction rate-setting process or a similar remarketing agent rate-setting process that is designed to produce the minimum dividend rate necessary to enable all interested sellers to sell the preferred stock to willing buyers at a price equal to the par amount of the applicable “liquidation preference” (typically, \$25,000), plus accrued but unpaid dividends. A “failed” auction or remarketing occurs if the auction or remarketing fails to produce buyers for all interested sellers at a dividend rate that is at or below the maximum dividend rate specified by the terms of the auction rate preferred stock. Upon a failed auction or remarketing, the dividend rate is reset at a prescribed maximum dividend rate until the next auction or remarketing. In addition, in the case of some issues of auction rate preferred stock, the dividend rate may escalate further to prescribed increasing maximum rates based on the continued occurrence of failed auctions or remarketings for increasing periods of time. The auction rate preferred stock generally is perpetual, optionally redeemable by the issuer at any time, and mandatorily redeemable in certain circumstances, such as upon a failure to meet certain asset coverage requirements. All

redemptions of auction rate preferred stock are subject to applicable state law restrictions on redemptions of stock.

This Notice only addresses auction rate preferred stock issued in the United States by closed-end management companies that are “regulated investment companies” (as defined in § 851 of the Internal Revenue Code) which invest predominantly in debt instruments and whose other investments are incidental to their business of investing in the debt instruments (“Eligible Issuers”).

2.2 Liquidity Facility

Presently, money market funds cannot hold auction rate preferred stock because it lacks the requisite liquidity features necessary to enable it to qualify as an eligible security for purchase by such funds under the Security and Exchange Commission’s Rule 2a-7, 17 C.F.R. 270.2a-7, issued under the Investment Company Act of 1940 (“Rule 2a-7”). In order to address liquidity needs in the auction rate securities market in response to recent auction failures, issuers and third parties seek to add liquidity facilities to support auction rate preferred stock and thereby to enable such stock to become eligible for purchase by money market funds under Rule 2a-7. Issuers and other interested parties reasonably expect that adding liquidity facilities to auction rate preferred stock and expanding the investor base for such stock to include money market fund investors will facilitate successful auctions.

The liquidity facilities for the auction rate preferred stock will be provided by third-party liquidity providers with terms and parameters that are described generally herein (“liquidity facilities” and “liquidity providers,” respectively). In general, the liquidity facilities will have terms intended to make the auction rate preferred stock covered by such liquidity facilities eligible for purchase by money market funds under Rule 2a-7. All current and future holders of auction rate preferred stock covered by a liquidity facility will be designated third-party beneficiaries of the liquidity facility and will have the right to enforce the liquidity facility directly against the liquidity provider.

A liquidity facility on auction rate preferred stock will provide to holders a tender option or right to sell such stock to the liquidity provider at a price equal to the stock’s liquidation preference, plus accrued but unpaid dividends, if one of the following two “trigger events” occurs: (1) a failed auction or remarketing; or (2) a failure to renew, replace, or extend an existing liquidity facility then in place with the same liquidity provider or another liquidity provider by a date that occurs at least two auction or remarketing dates before the termination date of the existing liquidity facility then in place.

In some cases, a liquidity facility for auction rate preferred stock may include an agreement by the issuer of the auction rate preferred stock to redeem the stock purchased by the liquidity provider under the liquidity facility after a minimum holding period of six months and after continuous good faith efforts to resell the stock in the periodic auctions at a price equal to the liquidation preference, plus accrued but unpaid

dividends. In other cases, a liquidity facility for auction rate preferred stock may be provided without any contractual rights of the liquidity provider to require the issuer of such stock to redeem or repurchase any such stock purchased by the liquidity provider under the liquidity facility.

Issuers anticipate that liquidity facilities typically, but not necessarily, will have a term of not more than 364 days for regulatory reasons. Issuers expect that they will be required to arrange for renewal, replacement, or extension of such liquidity facilities at least two auction or remarketing dates before expiration of existing liquidity facilities so that liquidity facilities will cover the auction rate preferred stock without interruption to facilitate qualification for purchase by money market funds under Rule 2a-7.

Issuers expect that liquidity providers will charge commercially reasonable liquidity fees for liquidity facilities, including commitment fees for the availability of the liquidity facilities and draw fees for draws to purchase stock under the liquidity facilities.

SECTION 3. Scope and Application.

3.1 In General. The IRS will not challenge the equity characterization of auction rate preferred stock, as described in § 2.1 of this Notice, for Federal income tax purposes as a result of adding a liquidity facility, as described in § 2.2 of this Notice, to support the auction rate preferred stock if the conditions of §§ 3.2 through 3.5 of this Notice are met and if the conditions of either § 3.6 or § 3.7, as applicable, of this Notice are met.

3.2 Certain Overall Limits on Scope. The issuer of the auction rate preferred stock must be an Eligible Issuer. The auction rate preferred stock had to be outstanding on February 12, 2008 (the date on which significant auction failures first occurred) or issued after that date to refinance, directly or indirectly, any auction rate preferred stock that was outstanding on that date, provided that the total par amount of the liquidation preferences on all such stock issued for refinancing purposes is no greater than the total par amount of the liquidation preferences on such outstanding refinanced stock. The liquidity facility must be an initial liquidity facility with respect to the auction rate preferred stock that is entered into after February 12, 2008 and on or before December 31, 2009 or a liquidity facility that renews, replaces, or extends such an initial liquidity facility, either directly or in a series of liquidity facilities.

3.3 Certain Limits on Dividend Payments. An issuer may pay dividends on auction rate preferred stock only if it duly declares such dividends and it pays such dividends out of legally available funds for payments in respect of stock under applicable state law.

3.4 Unrelated Liquidity Providers and Related Party Definition. The liquidity provider must be an “unrelated party” (as defined below) to the issuer of the auction rate preferred stock, as determined before taking into account any purchase of such stock by the liquidity provider under the liquidity facility. As used generally in this Notice, the

term “related party” means a party whose relationship to another party under § 267(b) or § 707(b) would result in a disallowance of losses, and an “unrelated party” is a party other than such a related party. Sections 3.6, 3.7, and 3.8 of this Notice also include certain provisions that consider related parties to issuers for purposes of redemptions or repurchases of stock or partnership interests from liquidity providers.

3.5 Certain Limits on Tender Options under a Liquidity Facility. The liquidity facility must provide to holders of auction rate preferred stock a tender option or right to sell their stock to the liquidity provider only if one of the following two trigger events occurs: (1) a failed auction or remarketing; or (2) a failure to renew, replace, or extend an existing liquidity facility then in place with the same liquidity provider or another liquidity provider by a date that occurs at least two auction or remarketing dates before the termination date of the existing liquidity facility then in place.

3.6 Certain Conditions on Rights of a Liquidity Provider to Require Redemption or Repurchase of Stock by Issuer. In the case of a liquidity facility for auction rate preferred stock in which the liquidity provider has any contractual rights to require the issuer of such stock or a related party to such issuer to redeem or repurchase stock purchased by the liquidity provider under the liquidity facility, any such contractual rights must be limited by applicable state law restrictions on redemptions of stock that apply to any holder of the auction rate preferred stock (e.g., state law restrictions on redemptions of stock which would impair the issuer’s required capital, surplus, or total assets). The liquidity provider must hold auction rate preferred stock purchased under a liquidity facility for a minimum continuous holding period of at least six months before any redemption or repurchase of such stock by the issuer or a related party to the issuer. During this required six-month holding period, the liquidity provider must offer such stock for resale at each periodic auction or remarketing duly held under the terms of the stock to set the dividend rate at a price equal to the par amount of the applicable liquidation preference, plus accrued but unpaid dividends. Except for any contractual rights provided to the liquidity provider to require the issuer of the auction rate preferred stock to redeem or repurchase stock purchased by the liquidity provider under the liquidity facility, the liquidity provider and any subsequent holder of such purchased stock otherwise must not have any greater rights with respect to such stock than other holders of the stock under the terms of the liquidity facility, the terms of such stock, or applicable state law.

3.7 Certain Liquidity Facilities Without Rights of a Liquidity Provider to Require Redemption or Repurchase of Stock by Issuer. In the case of a liquidity facility for auction rate preferred stock in which the liquidity provider has no contractual rights to require the issuer of such stock or a related party to such issuer to redeem or repurchase stock purchased by the liquidity provider under the liquidity facility, any redemption of such stock purchased by the liquidity provider or any subsequent holder of such purchased stock must be limited by applicable state law restrictions on redemptions of stock that apply to any holder of the auction rate preferred stock (e.g., state law restrictions on redemptions of stock which would impair the issuer’s required capital, surplus, or total assets). The liquidity provider and any subsequent holder of the

auction rate preferred stock must not have any greater redemption rights or other rights against the issuer of such stock or a related party to such issuer with respect to such stock than other holders of such stock under the terms of the liquidity facility, the terms of such stock, or applicable state law.

3.8 Certain Liquidating Partnerships That Hold Auction Rate Preferred Stock.

The IRS will not challenge the equity characterization of interests in a partnership for Federal income tax purposes as a result of adding a liquidity facility, as described in this § 3.8, to support the variable-rate interests in the partnership, as described in this § 3.8, if the conditions of this § 3.8 are met. The partnership must reasonably expect that at least 95 percent of the assets of the partnership will consist of auction rate preferred stock described in § 2.1 of this Notice that meets the conditions of § 3.2 and § 3.3 of this Notice and temporary investments of proceeds received from dispositions of such stock pending redemption of partnership interests. The partnership must issue two classes of equity interests: (1) interests that are entitled to a preferred variable return on capital payable out of partnership income (“variable-rate interests”); and (2) residual inverse interests that are entitled to all remaining income of the partnership. The variable-rate interests must be supported by liquidity facilities that have terms and limitations that are comparable to liquidity facilities described in § 2.2 of this Notice and that meet the conditions of § 3.2, § 3.4, § 3.5, and § 3.7 of this Notice (i.e., certain time limitations for liquidity facilities, limitations requiring liquidity providers to be unrelated parties to the partnership, permissible trigger events for liquidity facilities, and the absence of contractual rights of the liquidity provider to require the partnership or a related party to the partnership to redeem or repurchase the variable-rate interests in the partnership). The partnership must offer to sell the auction rate preferred stock that it holds at each periodic auction or remarketing duly held under the terms of the stock to set the dividend rates on such stock at a price equal to the par amount of the applicable liquidation preference on such stock, plus accrued but unpaid dividends. The partnership must apply proceeds received from sales, redemptions, or other dispositions of auction rate preferred stock that it holds promptly to redeem partnership interests and the partnership must not reinvest such disposition proceeds, except only for temporary reinvestments of such disposition proceeds for a reasonable period pending redemption of partnership interests. A partnership that meets the requirements of this § 3.8 and that otherwise constitutes a partnership for Federal income tax purposes is treated as eligible to make a monthly closing election under Rev. Proc. 2003-84, 2003-2 C.B. 1159, as in effect on June 13, 2008 (“Rev. Proc. 2003-84”). In applying the 95 percent qualified income test under § 4.02 of Rev. Proc. 2003-84, any dividends paid by an Eligible Issuer under this Notice shall be treated as qualified income for this purpose.

SECTION 4. No Inferences on Law

This Notice provides administrative relief in furtherance of public policy in light of significant liquidity needs in the auction rate securities market as a result of recent significant auction failures in this market. Except with respect to the administrative relief expressly provided in this Notice, no inferences should be drawn from this Notice

regarding the debt or equity character of any security, material modifications or exchanges of any security under § 1001, or any other Federal tax issues regarding any security. In addition, this Notice is not intended to address any other Federal tax issue implicated in the described transactions to add liquidity facilities to auction rate preferred stock.

SECTION 5. Effective Date

This Notice is effective on June 13, 2008. This Notice applies to auction rate preferred stock and to liquidity facilities within the time limitations and other limitations set forth in § 3.2 of this Notice. This Notice also applies to certain partnerships and liquidity facilities within comparable time limitations and other limitations set forth in §3.2 of this Notice as applied to certain partnerships and liquidity facilities under § 3.8 of this Notice.

SECTION 6. Drafting Information

The principal author of this Notice is Alfred C. Bishop of the Office of Associate Chief Counsel (Corporate). For further information regarding this Notice, please contact Mr. Bishop at (202) 622-7930 (not a toll-free call).